United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-1596 ORIGINAL

B
P/S

To be argued by
MARVIN LUBOFF

In The

United States Court of Appeals

For The Second Circuit

STUART D. WECHSLER, on behalf of himself and all others similarly situated,

Plaintiff-Appellant-Appellee,

vs.

SOUTHEASTERN PROPERTIES, INC.,

Defendant-Appellee-Appellant,

MONARCH FUNDING CORP., ANTHONY J. DeMATTEO, WILLIAM L. MANNING, JAMES HENRY, RONALD ULLENBERG, DAVID L. BOYD, H. T. BRADDOCK, GEORGE E. McGEE III and CHALMERS K. SMITH and HENRY McCORD, FORRESTER & RICHARDSON, EDITH COOPER, and SCHNEIDER & BARATTA,

Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

BRIEF FOR DEFENDANT-APPELLEE, MONARCH FUNDING CORP.

KANE, KESSLER, PROUJANSKY, PREISS & PERMUTT, P.C.
Attorneys for Defendant-Appellee Monarch Funding Corp.
680 Fifth Avenue
New York, New York 10019
(212) 541-6222

MARVIN LUBOFF
On the Brief

(7442) LUTZ APPELLATE PRINTERS, INC
Law and Financial Printing

South River, N. J. (201) 257-6850 | New York, N. Y. (212) 565-6377 | Philadelphia, Pa. (215) 563-5587 | Washington, D. C. (202) 783-7288

2

TABLE OF CONTENTS

Brief

TABLE OF CITATIONS

Cases Cited:

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- -x

STUART D. WECHSLER, on behalf of himself and all others similarly situated,

Plaintiff-Appellant-Appellee,

-against-

SOUTHEASTERN PROPERTIES, INC.,

Defendant-Appellee-Appellant,

MONARCH FUNDING CORP., ANTHONY J. DeMATTEO, WILLIAM L. MANNING, JAMES HENRY, RONALD ULLENBERG, DAVID L. BOYD, H. T. BRADDOCK, GEORGE E. McGEE III and CHALMERS K. SMITH, and HENRY McCORD, FORRESTER & RICHARDSON, EDITH COOPER, and SCHNEIDER & BARATTA,

Defendants-Appellees.

On Appeal From The United States District Court
For The Southern District Of New York

- -x

DEFENDANT-APPELLEE, MONARCH FUNDING CORP.'S BRIEF

PRELIMINARY STATEMENT

Defendant-appellee, MONARCH FUNDING CORP., submits this brief in opposition to plaintiff-appellant's appeal from that part of the order of the United States District

Court for the Southern District of New York (Knapp, J.) which denied his application for counsel fees and costs upon dismissal of this purported class action (345a).*

QUESTION PRESENTED

Under the conceded facts in this case, is defendant's counsel entitled to an allowance for counsel fees?

The District Court answered in the negative.

THE FACTS

On March 17, 1972, defendant SOUTHEASTERN PROPERTIES, INC. ("SOUTHEASTERN") first publicly offered 200,000 shares of its common stock at $5.00 per share to the public, pursuant to a Prospectus filed with the Securities and Exchange Commission (66a et seq., 247a).

On or about March 20, 1972, almost two months prior to the commencement of this action, trading in the stock

---

* Numerical designations followed by the letter "a" refer to the Appendix.

sold pursuant to that offering was suspended by the Attorney General of the State of New York ("Attorney General") (247a). On approximately March 22, 1972, the Attorney General was apprised that a million dollars was realized by SOUTHEASTERN from that offering which the Attorney General claimed, among other things: (1) was not filed or registered with the Department of Law of the State of New York as required by Article 23-A of the General Business Law (Martin Act), (2) failed to set forth in its Prospectus that a merger was proposed between SOUTHEASTERN and APOLLO INDUSTRIES, INC. ("APOLLO"). A notice was then sent by the Attorney General to defendant, SOUTHEASTERN, and their underwriter, defendant, MONARCH FUNDING CORP. ("MONARCH") requesting that SOUTHEASTERN make restitution of all monies obtained from the aforesaid securities offering (135a et seq., 258a).

In response to that notice and shortly after the suspension of trading, SOUTHEASTERN acted immediately to comply with the Attorney General's request. Through its managing officers, Anthony J. DeMatteo and William L. Manning, subsequently named as defendants in this action, SOUTHEASTERN voluntarily appeared at the offices of the

Attorney General and answered in full all questions which the Attorney General asked concerning the offering (247a).

By letters dated March 27, 1972 and May 19, 1972, SOUTHEASTERN advised its shareholders that it would not use the proceeds of the offering except to the extent necessary to keep intact its assets consisting principally of real estate, subject to various mortgage commitments and real estate taxes. The sum of $600,000.00 was deposited in a special account for the benefit of the SOUTHEASTERN shareholders pending the resolution of the Attorney General's claims. To aid in effecting a non-use of the offering proceeds, DeMatteo and Manning voluntarily reduced their salaries (248a, 267a, 304a).

On June 22, 1972, SOUTHEASTERN wrote to its shareholders and described the courses of action, including a rescission offer, it was exploring in connection with and to resolve the Attorney General's proceeding (177a).

During the spring, summer and fall of 1972, SOUTHEASTERN and its counsel and the Attorney General attempted to resolve the Attorney General's objections to SOUTHEASTERN'S offering. As a result of those negotiations,

SOUTHEASTERN, by letter dated August 14, 1972, informed its shareholders that it would effect a rescission of that offering (249a, 127-128a).

On September 12, 1972, the Attorney General, to formalize its actions, obtained an order in a proceeding in the Supreme Court of the State of New York, New York County, pursuant to the Martin Act directing most of the defendants named in this action to appear, testify and produce records and restraining the sale of SOUTHEASTERN securities in New York State as well as the transferring or disposing of any proceeds derived from the offering (129a et seq.)

On November 30, 1972, the Securities and Exchange Commission granted SOUTHEASTERN'S application to make a rescission offer without a registration statement in effect (250a). SOUTHEASTERN and the Attorney General then agreed to a consent injunction entered in the Supreme Court on December 21, 1972 which, among other things, directed SOUTHEASTERN to offer to rescind the 200,000 share offering at $5.00 per share (228a et seq., 250a).

In accordance with the consent injunction, SOUTH-

EASTERN liquidated several of its properties during January, February and March of 1973; SOUTHEASTERN'S transfer agent, on March 30, 1973 mailed a copy of the tender offer to each individual, business or broker which was an owner of record of SOUTHEASTERN shares on December 21, 1972 (213a et seq., 251a, 269a et seq.). SOUTHEASTERN, to supplement the mailing, placed two notices in the financial pages of the Wall Street Journal and The New York Times on April 6, 1973 (251-2a, 271a). Additionally, SOUTHEASTERN produced and made available an additional 500 copies of the tender offer which was distributed to numerous individuals who requested copies and to brokers at a window maintained by Bankers Trust Company in New York City. As of July 1973, 193,500 shares, out of the total of 200,000 or 96.75% of the shares of SOUTHEASTERN held by the public, were tendered (252a, 349a).

Plaintiff-appellant on April 13, 1973, in order to take advantage of the tender offer, and attempt to continue this law suit, tendered 290 of the 300 shares he owned and signed a general release (255a, 272-273a).

On May 2, 1972, almost two months after the Attorney

General commenced its activity, which resulted in the successfully completed rescission offer, plaintiff-appellant commenced this action which substantially alleges the same claims previously made by the Attorney General that the registration statement and prospectus of SOUTHEASTERN did not disclose that certain filings had not been made with the appropriate New York State governmental authority and failed to disclose the commencement of SOUTHEASTERN merger negotiations with APOLLO (5a et seq., 135a, 258a).*

Although plaintiff-appellant's counsel, in June 1972, learned of the Attorney General's action, plaintiff-appellant in July 1972, moved to have this duplicative action declared a class action (109a et seq., 348a). Judge Knapp, by memo order dated November 21, 1972, held that the record before the Court was inadequate to re-

---

* Plaintiff-appellant seeks to convey the image that because he commenced this action on May 2, 1972 before the Attorney General formally commenced action on September 12, 1972, he acted first and therefore contributed to bringing about the successful rescission. That image fades rapidly in light of the March 1972 activity of the Attorney General, not influenced by plaintiff or his counsel, which was commenced prior to the bringing of this action and which resulted in the rescission of the offering (350-1a).

solve plaintiff's questioning of the adequacy of the Attorney General's proceeding as a vehicle for protecting the rights of the class he aspired to represent and set the matter down for a hearing on December 12, 1972 to resolve that issue (196-7a).

At the hearing on December 22, 1972, a decision with respect to plaintiff's class action motion was again deferred to allow SOUTHEASTERN to effect the tender offer pursuant to the order obtained by the Attorney General (250-1a). Plaintiff's counsel then, in connection with the tender offer, wrote several letters, served interrogatories and moved to compel answers to interrogatories in an attempt to raise issues as to whether notice to stockholders in the tender offer was adequate (201a et seq., 232-4a, 262a, 275a, 277a).

SOUTHEASTERN complied with the essential provisions of its tender offer, which was successfully completed. The Attorney General's action was then basically concluded (252a, 349a). Motions were then made to dismiss this action (243a et seq.).

A hearing was held on July 31, 1973 on the motions to dismiss and on the issue of counsel fees to plaintiff's

counsel (315a et seq.) The issue was: is plaintiff entitled to ask the Court to make findings where there had been no determination of class status because of the pendency of the Attorney General's action (332a). Decision was reserved until the United States Court of Appeals for the Second Circuit decided the case of Grace v. Ludwig, 484 F. 2d 1262 (2d Cir. 1973), cert. denied, 40 L. Ed. 2d 110, involving similar issues, then pending before it (323a, 334a).

On April 4, 1974, after this Court decided the Grace case, Judge Knapp rendered an opinion dismissing the action denying counsel fees and costs to all parties (347a et seq.), and found:

(i) The Attorney General's action was adequate to protect the interests of the purported class in this action (348a);

(ii) The Attorney General was satisfied that SOUTHEASTERN complied with the provisions of its tender offer (349a);

(iii) The Attorney General was satisfied that SOUTHEASTERN took all reasonable steps to contact all persons who might

have had an interest in the tender offer (349a);

(iv) The Attorney General was satisfied that SOUTHEASTERN had established to his satisfaction its good-faith intention of complying completely with the terms of its tender offer to the full extent possible (349-350a);

(v) Plaintiff's counsel's arguments that this action might bring incidental benefits not available in the Attorney General's action did not justify continuing this law suit (350a);

(vi) The Attorney General's investigation was instituted prior to any action by plaintiff, or his counsel, and its initiation was in no way influenced by them (350-1a);

(vii) The Attorney General's action grew out of his own investigation and its initiation was in no way induced by any activity by plaintiff, or his counsel (351a);

(viii) Plaintiff, or his attorney, were not of any direct assistance to the Attorney General (351a);

(ix) No award to plaintiff for counsel fees was warranted (351a).

ARGUMENT

POINT

PLAINTIFF'S COUNSEL IS NOT ENTITLED TO A FEE AWARD.

Although, after an evidentiary hearing, Judge Knapp found that plaintiff and his attorney were not of any direct assistance to the Attorney General and were not entitled to a fee award, plaintiff-appellant claims it is entitled to a fee award because of the possibility that its action, commenced after the Attorney General effectively froze the proceeds of SOUTHEASTERN'S offering and commenced activity which resulted in the completed rescission of that offering, may have made some psychological contribution toward effecting the rescission. We respectfully submit that Judge Knapp properly found plaintiff's counsel's activities and any psychological contribution they may have had were insufficient to constitute a proper showing that the rescission was made and completed as a result of their efforts and, therefore,

they are not entitled to an award of fees.

The case of Grace v. Ludwig, supra, and the cases cited therein are controlling. There, a corporation applied to the Securities and Exchange Commission ("Commission"), for an exemption under the Investment Company Act of 1940 in connection with the absorbing by the Corporation of a 91%-owned subsidiary by a short form merger. Plaintiff, a minority shareholder of the subsidiary, retained counsel who, with the Commission's permission, attended the Commission's hearings. Counsel rejected the parent corporation's valuation of the subsidiary's shares and after that valuation was raised considerably, the parent corporation sought leave to and did withdraw its merger application. The Commission allowed withdrawal and denied counsel's fee application on the ground that it did not have jurisdiction to make such an award. Plaintiff then sued for attorney's fees and expenses claiming that the parent corporation doubled its offer to the shareholders of the subsidiary as a result of plaintiff and its counsel's efforts which therefore, thwarted the defrauding of the minority shareholders of the subsidiary, all of which entitled plaintiff's

counsel to a fee award.

Judge Knapp dismissed the complaint. Plaintiff appealed and the issue before this Court was whether the District Court as a court of equity should have awarded a fee. In affirming Judge Knapp's dismissal of the complaint, this Court held that plaintiff's counsel was not entitled to an award of fees.

This Court stated the general rule to be that although a successful litigant is not permitted to recover his attorney's fees as damages or as reimbursable costs in special circumstances, a court of equity does have the inherent power to reimburse a successful suitor for the costs of litigation, including his attorney's fees and found that the facts of the Grace case, (which are very similar to the facts in this case) did not constitute special circumstances warranting counsel fees, but raised considerations which would strongly militate against exercising discretion in favor of awarding such fees.

The Court continued that counsel fees are awarded in securities cases to encourage the vigilance of private Attorney Generals to provide corporate therapy protecting the public investor who might otherwise be victimized

where private attorneys provide the sole stimulus for the enforcement of law, such as where the Statute of Limitations is about to run and/or the corporation refuses to take action.

There were no special circumstances in Grace, because, as here, the Statute involved more than a simple reporting procedure or the mere submission of written materials for pro forma or perfunctory review by the SEC. It provided for a determination by the SEC only if evidence established fair and reasonable consideration which did not involve overreaching and was consistent with the policy of federal law.

Where the SEC called for and held extensive hearings to reach that determination, and plaintiff's counsel voluntarily participated in those hearings, his status was that only of a mere volunteer who aided a public body in the performance of its official duties on behalf of a certain class, which did not constitute special circumstances entitling him to a fee. This is so even if counsel was the laboring oar in the proceedings absent a showing that the SEC failed to have acted properly.

The Court continued that in any event the equitable

basis for a fee award is the prevention of unjust enrichment, meaning that where the plaintiff, at his own expense, has conferred a benefit upon the defendant justice demands he be recompensed and he is therefore entitled to his counsel fees. The Court held that no such benefit was conferred on the subsidiary by the plaintiff in the Grace case notwithstanding what had transpired before the SEC since, the merger application having been aborted, the intrinsic value of the subsidiary's shares were neither increased nor decreased.

The Court cited the case of Stolberg v. Members of Board of Trustees for the State Colleges of the State of Connecticut, et al, 474 F.2d 485, 2d Cir. 1973 as support for the theory that a court may award attorney's fees in favor of a party who is forced to litigate by reason of the vexatious, wanton conduct of a defendant who presents an unfounded defense.

The Court specifically referred to Judge Mansfield's opinion in Stolberg at 490, which reviews the unusual circumstances which authorizes the award of counsel fees and adopted Judge Mansfield's emphasis that counsel fees should be awarded where the action was compelled by the unusual circumstances of defendant's recalcitrant con-

duct. The Grace Court distinguished the Stolberg circumstances from the Grace case where the administrative proceeding was prompted by statute, defendants were not recalcitrant and the extensive participation of plaintiff's counsel was voluntary. This coupled with the fact that it could not be assumed that the SEC would have failed to act without counsel's being present required the denial of counsel fees.

The Court then held that there is no precedent for a recovery of counsel fees on the basis of a quantum meruit theory where no fund has been created and no new principle of law benefitting the class has been established resulting in a recovery to the class, and where plaintiff has not contributed to general corporate therapeutics by disclosing a fraud that otherwise would have gone undetected.

The Court also found that policy considerations were against such an award; to permit counsel fees in such a situation, it would face the impossible task of attempting to measure the value of the service of the intervenor. Such a precedent would encourage intervention in comparable cases before all agencies which would not only be dis-

ruptive of administrative procedures but might very well encourage agency inaction. The agency charged with the responsibility presumably has the expertise to carry out the mandate of the statute. To permit or encourage meddling by additional cooks might not only spoil the broth but paralyze the chef.

Here, as in Grace, the Attorney General commenced action pursuant to statute long prior to the voluntary intervention of plaintiff and his counsel.* Plaintiff-appellant's argument that they are entitled to an award of fees because they were for a period of time entitled to believe that SOUTHEASTERN would not make a rescission offer suggested by the Attorney General and that SOUTHEASTERN was actively engaged in using the public's money in conducting its business and that unless this action

---

* Plaintiff-appellant's attempted distinction of this action from that of Grace on the theory that the Grace attorneys intervened in the SEC proceeding and, here, the attorneys commenced a separate action under federal law, is a distinction without a difference. The circumstances are in fact the same because this duplicative action was, in effect, stayed pending the outcome of the Attorney General's action and Judge Knapp found that plaintiff's claimed incidental benefits which might be realized in the federal action did not warrant the continuation of this litigation.

was prosecuted, there was a danger that SOUTHEASTERN'S assets would be dissipated is unavailing in light of the Grace court's holding that there is a presumption that the governmental agency would properly prosecute its action. Indeed, prior to the commencement of his action, the Attorney General had effectively frozen the money SOUTHEASTERN had received from the offering, SOUTHEASTERN had deposited $600,000 in a special account for the benefit of its shareholders and had advised them in several letters of the status of the Attorney General's proceeding. In addition, SOUTHEASTERN personnel voluntarily reduced their salaries.

Furthermore, the chronology of events in this case reveal that the Attorney General's activity was commenced prior to the bringing of this private law suit and resulted in a completed rescission offer. The District Court found that plaintiff or his attorney were not of any direct assistance to the Attorney General whose action grew out of his independent investigation and was in no way induced by any activity of plaintiff or his counsel; that SOUTHEASTERN co-operated fully with the Attorney General in effecting the rescission offer and that plaintiff's activity did not contribute to

that result. Accordingly, plaintiff-appellant's are not entitled to an allowance as compensation for attorney's fees because there has been no showing that the rescission offer was made or completed as a result of their efforts, White v. Auerbach, et al., Slip Opinion 804, 805, Docket #73-2739, 73-2768, 2d Cir. July 24, 1974, page 14.

CONCLUSION

Plaintiff's voluntary and unnecessary action created no fund, produced no benefit and established no principle of law which resulted in a benefit to the shareholders of SOUTHEASTERN. It is impossible to measure the value of their claimed service as voluntary intervenors, and policy considerations militate against any award therefor.

For these reasons and those set forth in SOUTHEASTERN'S Brief, counsel fees should not be awarded to plaintiff- appellant and the order of the District Court should be affirmed.

Respectfully submitted,

KANE, KESSLER, PROUJANSKY,
PREISS & PERMUTT, P.C.
Attorneys for Defendant-Appellee,
MONARCH FUNDING CORP.

Marvin Luboff,
Of Counsel.

A 201 Affidavit of Service by Mail — LUTZ APPELLATE PRINTERS, INC.

U.S. COURT OF APPEALS:SECOND CIRCUTT

WECHSLER,
Plaintiff-Appellant-Appellee,

against

SOUTHEASTERN PORPERTIES,
Defendant-Appellee-Appellant.

Index No.

Affidavit of Service by Mail

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Laurel N. Huggins, being duly sworn,

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at

1050 Carroll Place, Bronx, New York

That upon the 14th day of August 1974, deponent served the annexed Respondent's Brief

upon * attorney(s) for

* in this action, at *

the address designated by said attorney(s) for that purpose by depositing 2 true copy of same, enclosed in a postpaid properly addressed wrapper in a Post Office Official Depository under the exclusive care and custody of the United States Post Office Department, within the State of New York.

Sworn to before me, this 14th day of August 1974

Laurel N. Huggins
Print name beneath signature

LAUREL N. HUGGINS

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, STATE OF NEW YORK
NO. 31 - 0413950
QUALIFIED IN NEW YORK COUNTY
COMMISSION EXPIRES MARCH 30, 1975

*Shatzkin & Cooper-Attorneys for Plf.-Applnt.-Applee.-235 E. 42nd Street., New York. 10017.

Schwartz, Burns, Lesser & Jacoby-Attorneys for Def.-Applee.-Applnt.-445 Park Ave, New York, 10022

Hart & Hume-Attorneys for Defs.-Appelles - 10 E. 40th Street, New York. 10016

Howard J. Goldstein-Attorney for Defs.-Appellees-1250 Broadway, New York 10001/